BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

MAY IT PLEASE THE COURT:

Grounds on which jurisdiction of this Court is invoked are stated in the preceding petition, which also refers to the opinions below and contains a summary statement of the case.

Statement of Facts.

The debtor corporation was organized in 1928 (R. 174). Title to a twenty-six flat apartment building was conveyed to the corporation by Angelo Castellani and Margaret Castellani (R. 179), subject to a mortgage securing an indebtedness of $100,000, with interest at 6% per annum, maturing on May 1, 1935 (R. 149). The building was erected at the height of the building boom in 1928 by the Castellanis, whose personal investment was $48,000 (R. 155-204). On May 1, 1933, the bondholders voluntarily agreed to reduce the interest rate from 6% to 4% (R. 52). Prior to May, 1935, the outstanding balance of the indebtedness being $85,900.00, the debtor filed a petition under Section 77B pursuant to which a plan of reorganization was put into effect by which maturity was extended to May 1, 1942, with interest at 3% per annum, with sinking fund provisions (R. 52). Prior to the extended maturity and when the petition was filed herein, the indebtedness, by means of the sinking fund, had been reduced to $72,500.00 (R. 5). During operation of the 77B plan then in force all of the net income from the property, after payment of taxes and interest, had gone into the sinking fund for the retirement of bonds (R. 175, 177, 185, 204). The Castellanis never received anything from the operations,

except that Angelo Castellani, as provided in the plan, received a commission of 4% for operating the property. He paid full rental on the apartment occupied by him (R. 175).

The petition was approved as filed in good faith (R. 11), and referred to a special master (R. 12). At a hearing on May 13, 1942, it was represented to the special master by a bondholder that the majority of the bondholders felt that they would much rather have a settlement of from 75 to 80% than an extension (R. 172). The debtor filed a plan or reorganization (R. 21) providing for retirement of the bonds by the negotiation of a loan on the property in the amount of $40,000 (increased to $50,000) and that Angelo Castellani would borrow, on his personal credit, $10,000, enabling immediate payment to bondholders of 70% (increased to 80%) of the face value of their bonds, the debtor paying all loan commissions, current bills, costs and allowances made by the Court. At a hearing on this plan on September 10, 1942, the special master stated that in his opinion the fair cash market value of the property was $62,250.00 (R. 199).

The special master reported to the Court that "there is every indication that at least 85 per cent of the face value of the bonds can be realized by the owners and holders of first mortgage bonds at a liquidation sale of the property herein involved". No notice of this report was sent to the bondholders generally, who knew only of the debtor's original plan providing for 70 cents on the dollar. At this point speculators desiring to acquire the debtor's assets solicited and acquired bonds from the then holders at prices ranging from 70 to 77 cents on the dollar without advising the sellers of the special master's report.

Following the concentration in the hands of William Bart of the speculatively acquired bonds, Bart filed objections to the debtor's amended plan of reorganization and objections to the special master's supplemental report of January 16, 1943 in which the special master stated that if the debtor should increase its offer to pay bondholders 85 cents on the dollar he would recommend to the Court approval of such plan (R. 51, 67). The debtor suggested that if the claims of the speculators were allowed only in the amount of the actual cost of the bonds the debtor would present an amended plan whereby the speculators would receive the amount which they paid for their bonds and the remaining bondholders the face amount of their bonds (R. 84).

The District Court held the matter under advisement for seven months and then, without notice, application or hearing, ordered that the debtor be removed from possession of the property, appointed a trustee and directed him to file a plan involving liquidation. This the trustee did, the "plan" being liquidation.

The debtor, its stockholders and a bondholder on November 1, 1943, presented a motion requesting leave to file a petition praying for the entry of an order limiting the allowance of claims based on bonds purchased during the pendency of the proceedings to the amounts actually paid for them (R. 168, 450, 452-456). On February 10, 1944, the Court entered an order permitting the filing of the petition and denying it. The petition set forth the activities of the speculators in considerable detail, charged that they "formed a plan to acquire enough of the outstanding bonds of the debtor to control the reorganization sought by these proceedings, conspired to thwart the functioning of the Bankruptcy Act and to defraud the debtor, its stockholders and certain of its creditors" (R. 452-456).

The statement of the Circuit Court of Appeals for the Seventh Circuit in affirming the order denying this petition that "the record discloses that the court had already made an adjudication of the issues involved before this petition was filed" *is incorrect.* The District Judge heard no evidence at any time. No issue was ever drawn and prior to the denial of the petition to limit claims no adjudication was ever made of the questions raised thereby. After hearings on the first plan proposed by the debtor the special master reported that "confronted with the conflicting testimony and the evidence of manipulations, schemes and financial intrigue that have been manifested by persons who had busied themselves acquiring bonds during the pendency of these proceedings" he was reluctant to place any confidence in their assurances, but there was then no issue as to the claims based upon such purchases and *the report was never passed upon by the Court.*

Appeals were taken both from the order of February 10, 1943, denying the petition to limit claims, and from the order of February 21, 1944, approving the trustee's plan for immediate liquidation by sale of the debtor's assets and distribution of the proceeds. *No finding of insolvency was ever made and no order adjudging the debtor a bankrupt was ever entered.*

Errors Relied Upon.

(1) The Circuit Court of Appeals was in error in holding that interference by speculators who connived and conspired to solicit and buy up bonds while a plan of reorganization was being worked out in a proceeding under Chapter X of the Bankruptcy Act and while the debtor's hands were tied, with the object of preventing reorganization and forcing liquidation, did not constitute a violation of Chapter X of the Bankruptcy Act or the general principles of equity jurisprudence.

(2) The Circuit Court of Appeals for the Seventh Circuit erroneously held that the District Court properly denied, without a hearing, the petition to limit claims purchased by speculators during the pendency of the reorganization proceeding to the amounts paid for them.

(3) The Circuit Court of Appeals for the Seventh Circuit erred in affirming the order of the District Court refusing to submit to the creditors the debtor's proposal to contribute additional funds, distribute immediately a substantial amount and pay the balance of all claims in full in five years with interest at 5%, or if such claims were so limited, to make immediate payment of all claims in full.

(4) The Circuit Court of Appeals for the Seventh Circuit erroneously stated, contrary to the record and to the fact, that "the record discloses that the court had already made an adjudication of the issues involved before this petition was filed."

(5) The Circuit Court of Appeals for the Seventh Circuit erroneously held that under such circumstances Chapter X of the Bankruptcy Act upon a voluntary petition for reorganization permits liquidation under the guise of reorganization without an adjudication in ordinary bankruptcy.

Summary of the Argument.

Chapter X of the Bankruptcy Act was enacted to give the debtor and its creditors an opportunity to work out a plan of reorganization in order to avoid liquidation. While the court is in the process of working out a fair and feasible plan agreeable to the debtor and more than two-thirds of its creditors interference by speculators with no previous interest who, while the debtor's hands are tied, conspire and connive to solicit and buy up more than two-thirds of the debtor's bonds *at less than the holders can obtain*

from the debtor, with the object of thwarting the Act and forcing liquidation, is in violation of the Act and contrary to the principles of equity jurisprudence. These activities should not be encouraged and aided by the court but the claims so purchased should be limited to the consideration paid therefor. Under such circumstances the court should not refuse to submit to the bondholders a fair plan submitted by the debtor to contribute additional money, make immediate distribution to bondholders of a substantial amount, and pay the balance in full in five years with interest at 5%, or, if such claims are so limited, to make immediate payment of all claims in full. Under such circumstances Chapter X does not permit liquidation upon a voluntary petition for reorganization without an adjudication in ordinary bankruptcy and it does not contemplate liquidation under the guise of reorganization.

ARGUMENT.

In *Case* v. *Los Angeles Lumber Co.*, 308 U. S. 106, 124, this Court said that one of the purposes of Section 77B was to avoid the consequences to debtors and creditors of foreclosures, liquidations and forced sales with their drastic deflationary effects. After the parties are brought into the bankruptcy court the interest of all, creditors and debtor alike, are to be determined according to the principles of equity. It was not the intention of Congress to offer relief to speculators in equities. Here the speculators formulated a scheme the effect of which was not only to deprive the legitimate bondholders or original owners from receiving the actual value of their bonds, but particularly to defeat the approval by the court of any plan whereby the debtor might satisfy all of its creditors and have something left. Settled principles of equity should prevent these speculators from enforcing any claim for more than the amount paid, with interest and expenses.

Chapter X of the Bankruptcy Act requires the court to take pains to determine whether settled principles of equity may not disable the assignee of a claim acquired during the proceedings from receiving more than he paid therefor:

Section 612 of the United States Code provides that the judge may limit to the actual consideration paid therefor any claim acquired in the course of a proceeding by an attorney purporting to represent any creditor. In this case one Rubin, purporting to represent Bart in whose name

all of the speculatively acquired bonds were subsequently concentrated, sent telegrams personally soliciting bonds during the proceeding (R. 416, 417, 418, 233), and personally entered into a contract during the proceeding for the purchase of other bonds (R. 419).

Section 576 provides (italics ours) that "*no person* shall, without the consent of the court, *solicit* any acceptance, conditional or unconditional, of any plan or any *authority*, conditional or unconditional, to accept any plan, whether by proxy, *deposit*, power of attorney, or *otherwise*, until after the entry of an order approving such plan * * * "

Section 603 requires the judge in acting on a plan to investigate and consider the good faith and propriety of the acceptances and the time of acquiring the claims.

Section 610 prohibits an attorney from being heard until he has filed a statement with the court showing the time of acquisition of the claims represented by him.

Section 611 requires every person representing more than twelve creditors to file a statement reciting the facts and circumstances of his employment, the amount of the claims owned by him, the times when acquired and the amounts paid therefor.

Section 613 prohibits an agent of creditors from being heard until he has satisfied the court that he has complied with all applicable laws regulating the activities of such persons.

It was not contemplated by Congress that the very purpose of the Act and object of the proceeding should be thwarted by the purchase of claims during the proceedings and that the court should place its *imprimatur* upon "manipulations, schemes and financial intrigue that

have been manifested by the individuals who have busied themselves acquiring bonds during the pendency of these proceedings." (Special Master's report, R. 62.)

By its judgment affirming the order denying the petition of the debtor, its stockholders and a bondholder, without requiring an answer thereto, or a hearing, the Circuit Court of Appeals, in effect, has held that the petition was insufficient as a matter of law. This court, in *American Insurance Co.* v. *Avon Park,* 311 U. S. 138, 145, has plainly indicated that the court has ample power to deal with a situation involving unfair dealing, special benefits to a few, etc., to say nothing of a deliberate intent and plan to thwart the purpose of the Bankruptcy Act.

In determining that there should be a liquidation in this case and that it was not necessary that there be an adjudication in ordinary bankruptcy the District Court and the Circuit Court of Appeals considered that the statement of this Court in *Fidelity Assurance Assn.* v. *Sims,* 318 U. S. 608, was a mere dictum to be disregarded. In that case this Court said:

> "Under the predecessor of Chapter X—Section 77B of the Bankruptcy Act—the district judge was given authority by sub-section c (8), under certain circumstances, to 'direct the estate to be liquidated, or direct the trustee or trustees to liquidate the estate * * *.' In Chapter X on the other hand, section 236 (2) provides that if no plan is approved or accepted, or if it is not consummated, the judge may, after hearing all persons in interest, adjudge the debtor a bankrupt, or dismiss the proceeding as he may decide is in the interest of creditors and stockholders. Thus the statute does not contemplate a liquidation in a Chapter X proceeding but a liquidation in ordinary bankruptcy or a dismissal outright."

It is respectfully submitted that careful examination of the opinion of the District Court in that case (42 Fed. Sup. 973), the opinion of the Circuit Court of Appeals (129 Fed. 2d. 442), the petition for certiorari, and the briefs, plainly shows that the language of this court above quoted was not a mere *obiter dictum,* but that the question was actually presented and necessarily presented for the decision of this court.

Paragraph (2) of Rule LII of the Rules in Bankruptcy of this court provide that General Order in Bankruptcy No. XVIII, having to do with the sale of property, shall not apply to proceedings under Chapter X of the Act "unless an order shall be entered directing that bankruptcy be proceeded with pursuant to the provisions of the Act."

Under Section 616 a plan of *reorganization* may provide for a class of creditors which has not accepted a plan by the sale of property free of such claims and the transfer of the claims to the proceeds of such sale. However, Chapter X does not contemplate *liquidation* under this provision by calling it "reorganization".

Whether or not the court has the power, in a proper case, to approve a plan providing for the liquidation of a debtor's assets, such power should not be exercised when its exercise places the stamp of approval upon such activities as those disclosed by this record.

It is respectfully submitted that the Circuit Court of Appeals erroneously cast aside these considerations and principles in order not to "destroy or impair the sales value of securities by abolishing the profit motive which inspires purchasers."

WHEREFORE it is respectfully submitted that this petition should be granted.

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